COUNTERACTING TAX EVASION IN MALAWI: AN ANALYSIS OF THE METHODS AND A QUEST FOR IMPROVEMENT

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COUNTERACTING TAX EVASION IN MALAWI: AN ANALYSIS OF THE METHODS AND A QUEST FOR IMPROVEMENT

By

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ABSTRACT

Tax Evasion is one of the major problems that Tax Administrations face the world over. This is however more pronounced in Developing countries. Tax Evasion is defined in this paper as the act of illegally paying less taxes (or not paying at all) than the amount legally required by the tax law. This is in contrast to Tax Avoidance which contains some elements of legality as it is defined as the reduction of tax liability by practices that take full advantage of the loopholes in the tax law.

There are several reasons that have been cited as the major causes of Tax Evasion, especially in developing countries. Among such reasons are high tax rates that increase tax burdens, inadequate and weak tax law legislations which are coupled by lower levels of tax law enforcement, general dissatisfactions with the public service provisions and, the presence and extent of the parallel economy in these countries.

This paper focuses on analyzing the methods that Malawi employs in counteracting Tax Evasion and how they can be improved. At the core of the paper is the fact that Tax Evasion can be controlled by looking at the Tax law and also the various administrative measures that go along with enforcing it. It further singles out and recommends reviews in the Tax Law such as the enhancement of penalties and the broadening of transactions that require Tax Clearance Certificates, such as the tendering process. The paper also recommends a review in the staff capacity and its abilities, Assessment system, Incentive scheme and also tackling of the parallel economy in a bid to bring it into the taxable fold through the analyzing of Withholding Tax and Import and Export records.
SECTION 1

1.0 INTRODUCTION

Most Developing Countries rely on Tax Revenues to finance their budgets, on top of other sources of Revenues such as Loans and Grants from multilateral and bilateral donors. Despite this scenario, Tax evasion in most developing countries is so rampant, and the scenario is much worsened by the fact that not many of these governments have made an effort to measure the extent of this problem and at the same time analyze its impact. In addition, it is hard to investigate Tax Evasion as it is done in such a way as not to leave any traces. Studies that have been done in this area have confirmed these observations. In their paper, On Policy Reforms and the Missing Revenues, Ardt and Tarp (2003) reviewing McLearn (1996), observed that the value of evaded taxes is often close to the value of the actual collection for the major taxes. Reacting to the need for more Revenue, these countries have tended to increase tax rates to their relatively small tax bases which in increase the incentive for taxpayers to evade. Other governments resort to Domestic Borrowing which may not only crowd out the private sector of their economies but also lead them to debt traps. On the other hand, Tax evasion has the effect of distorting the principle of perfect market resource allocation and income redistribution. This can lead to economic growth stagnation in such countries, a scenario that can have far much reaching socio-economic repercussions.

1.1 RATIONALE AND OBJECTIVES OF THE STUDY

Malawi, being one of the developing countries, is not exempt from the above described scenario. It relies on Tax Revenue to finance almost 50% of its fiscal budget and it also forms almost 90%
of its total Domestic Revenue. Despite the fact that there have been no intimate studies on Tax evasion, which apart from denying the government of the much needed revenue also violates the principles of vertical and horizontal equity in taxation, its presence is widely accepted.

It is on this background that this study is justified as it will analyze the current measures being used to counteract tax evasion and also suggest new methods that can be employed to check the practice.

1.2 ORGANIZATION OF THE PAPER

This paper is divided into six sections. Section 2 gives a brief history of taxation in Malawi up to the present and also general tax revenue performance for the past 10 year. Section 3 is a survey of Tax Evasion in literature. It also gives the definition of the term and also explores some of its causes. Section 4 looks at Tax Evasion in Malawi and tries to establish its extent. In section 5 we look at the major methods being employed to counter tax evasion in Malawi both legally and administratively. In the latter part of this Section we analyze the methods and also suggest how they can be improved. We also suggest some other ways through which the problem of tax evasion can be contained. Section 6 concludes the paper while Section 7 contains the bibliography and appendix.
SECTION 2

2.0 A BRIEF HISTORY OF TAXATION IN MALAWI.

Malawi, just like almost all countries in Africa, was colonized by the British after they had declared it a British Protectorate in 1891. It got its independence on 6th July, 1964. There is not much documentation on the history of Taxation in Malawi during the pre-colonial period. (i.e. before 1891). Oral history however indicates that locals were paying some form of taxes in kind to Tribal Chiefs who in turn provided them security from other invading tribes.

During the colonial period (1891-1964), there was a form of taxation called Hut Tax, which was heavily resisted by the natives since it was seen as one way of oppression. In 1963, the first Taxation Act was enacted but it took effect in January, 1964. This Act covers Cooporate and Income taxes only. On 1st June 1969, the Customs and Excise Act which covered Indirect taxes was enacted. However in 2001, a separate Act was enacted which covers the Value Added Tax.

After independence Taxes were being collected by departments of Income Tax, which collected Income Taxes and the Customs and Excise which collected Indirect Taxes in the Ministry of Finance.

2.1 THE MALAWI REVENUE AUTHORITY

In the 1990s, the Malawi government with the assistance from the International Monetary Fund and the World Bank undertook a Structural Review and Reform of its departments. The structural reform embedded a functional review which saw the merging of the two Tax collecting departments of the Ministry of Finance into a more efficient and effective body called the Malawi Revenue Authority (hereafter referred to as MRA). This was established as a permanent corporate body, enacted in 1998 and was launched in 2000. A board that is responsible for policy
direction governs MRA. It is headed by a Commissioner General. It has 7 divisions namely Customs and Excise, Income Tax, and VAT, headed by a Commissioners, Information Technology, Finance and Administration, Policy Planning and Research, and Tax Audit and Investigation, headed by Directors. It has other functional departments being those of Legal, Public Relations and Taxpayer Education, Security and Internal Audit. The Finance and Administration department has other departments’ as well, refer to appendix I for an organogram.

2.2 TAXES OF MALAWI

Malawi levies taxes on Income, Consumption, and international trade (however taxes on exports were abolished in 1998 to encourage exports). Table 2.1 is a summary of these taxes, their base.

Table 2.1: Major Taxes of Malawi (as at April 2006)

<table>
<thead>
<tr>
<th>Tax Base</th>
<th>Name of tax</th>
<th>Division responsible for Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income (Direct)</td>
<td>Cooperate</td>
<td>Income Tax</td>
</tr>
<tr>
<td></td>
<td>Individual</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Fringe Benefit</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Withholding Pay As You Earn (for Salaried employees)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Non resident</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Provisional (an advance payment of income Tax paid in quarterly installments)</td>
<td></td>
</tr>
<tr>
<td>Consumption (Indirect)</td>
<td>Domestic VAT</td>
<td>VAT</td>
</tr>
<tr>
<td>International Trade (Indirect)</td>
<td>Customs</td>
<td>Customs and Excise</td>
</tr>
<tr>
<td></td>
<td>Excise</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Import VAT</td>
<td></td>
</tr>
</tbody>
</table>
2.2 REVENUE PERFORMANCE

The MRA has been performing well in terms of Revenue collection since its inception. This is evidenced by an increase in revenue trends from one year to the other. Upon its inception there was a jump in the levels of Revenue collected which has been maintained. Figure 1 and 2 below shows the general trend in Revenue Collection and the performance of Direct and Indirect Taxes. However chances are that the Revenue Body would have been collecting much more if it were not for Tax Evasion, which has not been factored in the picture.

Figure 1
Figure 2

Tax Revenue as a Percentage of GDP 1993-2004

- Tax Revenue as a % of GDP

% Values

Years

SECTION 3

3.0 TAX EVASION, DEFINITION

Tax Evasion has been defined widely in literature with most definitions being with respect to a particular type of Tax, i.e. either indirect or direct. It has also been defined in contrast to Tax Avoidance. This paper will look at both terms and then propose a working definition of tax evasion as this is our main focus.

Kay, (1980) defined Tax evasion as an act concerned with concealing or misrepresenting the nature of a transaction while Tax Avoidance takes place when facts of the transaction are admitted but they have been arranged or presented in such a way that the resulting tax treatment differs from that intended by the relevant legislation. Alm and Vazquez (2001) define Tax evasion as the illegal and intentional action taken by individuals and firms to reduce their legally due tax obligation by under reporting incomes, sales or wealth, overstating deductions, exemption or credits or simply by failing to file the appropriate tax returns. On the other hand, they define Tax avoidance as the legal reduction in tax liabilities by practices that take full advantage of the tax code, such as income splitting, postponement of taxes and tax arbitrage across incomes that face different treatments. From these two sets of definitions it can be seen that paying less tax or not at all than what one is legally obliged to, is tantamount to Tax Evasion while Tax Avoidance is an act of doing everything possible within the confines of the Tax Law to reduce (or not incur at all) the tax bill. Thus the difference between Tax Evasion and Tax Avoidance will hinge on the legality of the taxpayers action. From a moralistic point of view, Tax Avoidance is viewed as undesirable as it constitutes an act of exploiting loopholes in the Tax
Law in order to reduce the tax burden, the result of which, just like Tax Evasion, is a reduction of Tax Revenue for the Government or the state. This paper adopts a working definition of Tax Evasion as the act of ILLEGALLY paying less (or not paying at all) Taxes than the amount legally required by the Tax Law.

3.1 TAX EVASION INVESTIGATED, A LITERATURE REVIEW

The subject of Tax Evasion has been widely studied from various angles in literature, among which has been the angle that has tried to identify the causes of Tax Evasion.

By nature people are not comfortable to willingly pay taxes, because the benefits of the Tax paid do not accrue directly to the Taxpayer. Thus Taxes are generally paid out of an obligation rather than a necessity to the government. This naturally derives the zeal in the Taxpayer to reduce this perceived Tax Burden,

Chipeta (2002) identifies three causes of Tax Evasion. Firstly, the rates at which taxpayers are being taxed. He observes that the higher the rate, the higher will be the likelihood for the Taxpayers to evade, as this increases their Tax Burden and hence lowers their disposable income.

This fact is in complete tandem to the pioneering studies in Tax Evasion done by Alligham and Sandmo (1972) who also observed a positive correlation between Tax rates and Evasion.

Secondly, the probability of being detected after evading taxes also influences the decision of a Taxpayer as whether to evade or not. This is directly linked to the level of how strict Tax Laws are being enforced. Thirdly, also directly related to the level of Tax Law Enforcement, is the level of penalties that are incurred after an evasion has been detected. Higher penalties usually
act a detergent to evasion, as they reduce the future payoff to the evading Taxpayer.² Fishlow and Friedman (1994) summarize this fact by elaborating that Tax Evasion increases when the expected ratio of future to current income increases.

The level of corruption in society also has a strong bearing on Tax Evasion. If the cost of corrupting a Tax official is lower than the benefit of accruing from evasion, a Taxpayer will likely indulge in evasion. Acconnia et al, (2003) observes that in an economy the level of corruption and Tax Evasion hinges on such factors as the wealth of the Taxpayer and the wage of the Tax Official. Maclean (1996) further works on a model, which tries to identify the optimal wage at which Tax Officials should be remunerated. He argues that Governments face the dilemma of identifying, a wage level which will ensure that its Tax officials are not enticed to bribery, as there is a link between the wage level of Tax Officials and Tax Evasion via corruption.

Failure by the Government to provide basic Public Goods and other Social amenities which are supposed to be funded by the Taxes being collected may aggravate Tax Evasion (Pashev, 2005). Lack of Transparency and Accountability is the use of Public Finances has the effect of building public distrust both in the Tax System as well as the Government, thereby playing up the chances of Tax Evasion.

Tax Evasion is also linked to the concept of Parallel Economy. A parallel economy of a country includes not only illegal activities but also unreported income from production of legal goods and services either from monetary or barter transactions (Schneider, 1994). From this definition it is therefore normal to conclude that Tax Evasion will be higher in countries with a large Parallel Economy and lower in countries with a small Parallel Economy.

² However, Virmani (1987) notes that a rise in penalties for Tax Evasion may easily result in a drop in Tax Revenue, since the rise in penalties raises the benefit for a Tax Official and taxpayer to incur the risk of striking a bargain to evade.
measures of the Parallel Economy in Literature, such as that of Tanzi (1983), Bhattacharyya (1990) Maliyamkono and Bagachwa (1990) and Ogunc and Yilmaz (2000). A good summary of the measurements can however be found in Schneider and Enste (1999) who present estimates from 76 Developing, Transition and OECD countries. The average size of the parallel economy varies from 12% of GDP for OECD countries, to 23% for Transition to 39% for developing countries. Thus parallel economies are large in Developing and Countries in Transition. It follows therefore to conclude again that Tax Evasion is high in these countries. Tax Evasion is not however the same as parallel economy although the existence of a Parallel Economy increase Tax Evasion. Reducing the parallel economy also leads to a reduction of Tax Evasion. This can be ably achieved by tackling the major factors that force economic agents to opt to operate in the parallel economy. Tax burden\(^3\) is cited as one of such factors, others being the red tape in the requirements of operating in the official economy and a general decline in allegiance to state laws as a result of citizenry non satisfaction in public service provision.

\(^3\) Defined as Tax paid in a period as a proportion of total income. Agents would like to reduce this proportion as much as possible and hence one option available for them is to operate in the parallel economy where their activities are not recorded.
SECTION 4

4.0 THE ECONOMY AND TAX EVASION IN MALAWI

4.1 INTRODUCTION

Taxation is viewed as a burden by most taxpayers. This is because tax rates are generally high and hence end up reducing disposable incomes. Economic agents try to compensate this deficiency in a number of ways, such as borrowing capital for investment, however the situation in most developing countries is that the cost of borrowing is high and in some cases there is no readily available capital for them to borrow. Tax evasion and or avoidance become a viable option ceteris paribus.

Malawi’s economy has been growing at an average rate of 4% for the past ten years, with economic sectors pointing at taxes, as one of the hindrances to their growth. Its tax rates though comparing favorably with its neighbors are generally high if compared globally and other advanced economies. (Refer to Table 4.1). Such a scenario has created a fertile ground for a parallel economy and hence Tax Evasion. This has all been against a backdrop of several tax reforms which the country has undertaken; however, tax evasion is still a problem, an indication that the tax policy among many other policies in place needs to be revisited by the authorities.
Table 4.1: Tax rate comparisons

<table>
<thead>
<tr>
<th>Country</th>
<th>Income Tax rate (%)</th>
<th>Consumption Tax rate (%)</th>
<th>Customs Duty Rate (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Individual (highest bracket)</td>
<td>Cooperate</td>
<td>Highest</td>
</tr>
<tr>
<td>Malawi</td>
<td>35</td>
<td>30</td>
<td>17.5</td>
</tr>
<tr>
<td>Mozambique</td>
<td>32</td>
<td>32</td>
<td>17</td>
</tr>
<tr>
<td>Tanzania</td>
<td>30</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td>Zambia</td>
<td>40</td>
<td>35</td>
<td>17.5</td>
</tr>
<tr>
<td>Botswana</td>
<td>25</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>Japan</td>
<td>37</td>
<td>30</td>
<td>5</td>
</tr>
</tbody>
</table>

4.2.1 EXTENT OF TAX EVASION, THE MEASUREMENT PROBLEM

Tax evasion can be categorized into two groups. The first category involves activities of the Parallel Economy where no income is reported at all, while the second category involves the use of other means such as falsification of financial record, overstatement of tax deductions and other similar means.

Establishing the presence and let alone the extent of Tax Evasion is a daunting task. However, there are two methods that are applied to try to circumvent this problem. Firstly, there are Direct Methods which entail administration of a structured questionnaire to taxpayer about their income declaration and or the use of Tax Audits. The main drawbacks of the survey method is that it heavily depend on the honesty of the respondents and by nature not many people could voluntary
disclose the amount of tax they evaded or their undeclared income. The major drawback of tax audit is that it may not be feasible to audit all taxpayers and even where it is possible, not all the evaded tax can be detected and there are also chances of wrongly accusing a taxpayer of evasion when in fact there is no evasion. Secondly, there are indirect methods. Their common characteristic is that they use other macroeconomic parameters to establish tax evasion and its extent. The methods estimate the size of the Parallel Economy from which the presence of tax evasion and its extent are established. In this paper we adopt the use of one of the indirect method as we believe that the tax that has been evaded in the formal economy ends up in the parallel economy. Specifically we make use of the Currency Demand Method.

### 4.2.1 Currency Demand Method

The Currency Demand Method, also known as the Guttmann method is a monetary technique of estimating the size of the parallel economy. The method is premised on the general movements on the demand of currency. It is assumed that there is a constant ratio of currency in circulation to the demand deposits in an economy. Any increase in this ratio translates into an increase in the use of cash and attributed to an increase in the activities of the parallel economy where cash transactions are preferred to other forms of payments as cash does not leave any traces. Further this implies that all payments in the parallel economy use cash. The parallel economy is therefore estimated by getting a product of the estimated income velocity and the estimated currency used in the parallel economy, using the formula below:

\[
Y_p = \left[ \frac{Y_o}{DD \left(1 + CC/DD_B \right)} \right] \left[ M 1 - DD \left(1 + CC/DD_B \right) \right]
\]

where \( Y_p \) = the parallel economy GDP
\[ Y_0 = \text{the official economy GDP} \]

\[ M1 = \text{Narrow money} \]

\[ DD = \text{demand deposits} \]

\[ CC = \text{Currency in Circulation} \]

\[ CC/DD_B = \text{the ratio of currency in circulation to demand deposits in a base year.} \]

Using the above formula and taking a cue from Chipeta (2001), we estimate the parallel economy for Malawi from 1990 to 2004. Just like Chipeta we take 1977 as our base year since it was a year with the smallest \( CC/DD_B \) ratio of 0.54., implying that the Parallel economy was almost negligible. The table 4.2 shows the results:-

**Table 4.2: Estimation of the Parallel Economy in Malawi**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>CC</th>
<th>DD</th>
<th>CC/DD</th>
<th>M1</th>
<th>( Y_0 )</th>
<th>( Y_P )</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>159.40</td>
<td>244</td>
<td>0.6533</td>
<td>403.40</td>
<td>4,799.20</td>
<td>353.018</td>
</tr>
<tr>
<td>1991</td>
<td>222.70</td>
<td>295.6</td>
<td>0.7534</td>
<td>518.30</td>
<td>6,046.80</td>
<td>837.847</td>
</tr>
<tr>
<td>1992</td>
<td>289.80</td>
<td>385.9</td>
<td>0.7510</td>
<td>675.70</td>
<td>6,343.70</td>
<td>869.053</td>
</tr>
<tr>
<td>1993</td>
<td>414.20</td>
<td>505.9</td>
<td>0.8187</td>
<td>920.10</td>
<td>8,940.50</td>
<td>1618.224</td>
</tr>
<tr>
<td>1994</td>
<td>624.70</td>
<td>789.3</td>
<td>0.7915</td>
<td>1414.00</td>
<td>11,025.80</td>
<td>1800.361</td>
</tr>
<tr>
<td>1995</td>
<td>987.50</td>
<td>1,085.7</td>
<td>0.9096</td>
<td>2073.20</td>
<td>23,221.90</td>
<td>5572.524</td>
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<tr>
<td>1996</td>
<td>1223.80</td>
<td>1,388.4</td>
<td>0.8814</td>
<td>2612.20</td>
<td>38,086.50</td>
<td>8444.476</td>
</tr>
<tr>
<td>1997</td>
<td>1375.30</td>
<td>1,691.3</td>
<td>0.8132</td>
<td>3066.60</td>
<td>45,851.60</td>
<td>8133.046</td>
</tr>
<tr>
<td>1998</td>
<td>1980.00</td>
<td>2,405.0</td>
<td>0.8233</td>
<td>4385.00</td>
<td>57,810.60</td>
<td>10634.328</td>
</tr>
<tr>
<td>1999</td>
<td>2992.00</td>
<td>3,424.5</td>
<td>0.8737</td>
<td>6416.50</td>
<td>77,088.50</td>
<td>16704.387</td>
</tr>
<tr>
<td>2000</td>
<td>4144.90</td>
<td>4,626.3</td>
<td>0.8959</td>
<td>8771.20</td>
<td>102,704.70</td>
<td>23738.308</td>
</tr>
<tr>
<td>2001</td>
<td>4310.40</td>
<td>6,277.1</td>
<td>0.6867</td>
<td>10587.50</td>
<td>121,401.40</td>
<td>11563.604</td>
</tr>
<tr>
<td>2002</td>
<td>5964.00</td>
<td>7,476.1</td>
<td>0.7977</td>
<td>13440.10</td>
<td>145,325.00</td>
<td>24322.322</td>
</tr>
<tr>
<td>2003</td>
<td>7838.30</td>
<td>9,625.9</td>
<td>0.8143</td>
<td>17464.20</td>
<td>168,649.40</td>
<td>30038.505</td>
</tr>
<tr>
<td>2004</td>
<td>10992.80</td>
<td>14,450.7</td>
<td>0.7607</td>
<td>25443.50</td>
<td>202,387.00</td>
<td>29005.810</td>
</tr>
</tbody>
</table>
We estimate the tax evaded for the period in question by calculating the percentage of tax revenue to GDP for each year and then subjecting the same burden to the Parallel Economy GDP. The assumption is that if parallel economy was taxed, it would yield the same percentage of tax revenue for each given year. The table 4.2 below is a summary of the results:

**Table 4.2: Estimation of Tax evaded**

<table>
<thead>
<tr>
<th>Year</th>
<th>$Y_0$ (MK million)</th>
<th>Tax Rev (MK million)</th>
<th>Tax burden</th>
<th>$Y_P$ (MK million)</th>
<th>ETR EV (MK million)</th>
<th>%ETR/TR</th>
<th>%ETR/$Y_0$</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990</td>
<td>4,799.20</td>
<td>888.00</td>
<td>18.50</td>
<td>353.02</td>
<td>65.32</td>
<td>7.36</td>
<td>1.36</td>
</tr>
<tr>
<td>1991</td>
<td>6,046.80</td>
<td>998</td>
<td>16.50</td>
<td>837.85</td>
<td>138.25</td>
<td>13.85</td>
<td>2.29</td>
</tr>
<tr>
<td>1992</td>
<td>6,343.70</td>
<td>1100</td>
<td>17.34</td>
<td>869.05</td>
<td>150.69</td>
<td>13.70</td>
<td>2.38</td>
</tr>
<tr>
<td>1993</td>
<td>8,940.50</td>
<td>1134.77</td>
<td>12.69</td>
<td>1618.22</td>
<td>205.39</td>
<td>18.10</td>
<td>2.30</td>
</tr>
<tr>
<td>1994</td>
<td>11,025.80</td>
<td>1298.52</td>
<td>11.78</td>
<td>1800.36</td>
<td>212.03</td>
<td>16.33</td>
<td>1.92</td>
</tr>
<tr>
<td>1995</td>
<td>23,221.90</td>
<td>2061.22</td>
<td>8.88</td>
<td>5572.52</td>
<td>494.63</td>
<td>24.00</td>
<td>2.13</td>
</tr>
<tr>
<td>1996</td>
<td>38,086.50</td>
<td>3867.23</td>
<td>10.15</td>
<td>8444.48</td>
<td>857.44</td>
<td>22.17</td>
<td>2.25</td>
</tr>
<tr>
<td>1997</td>
<td>45,851.60</td>
<td>5389.34</td>
<td>11.75</td>
<td>8133.05</td>
<td>955.95</td>
<td>17.74</td>
<td>2.08</td>
</tr>
<tr>
<td>1998</td>
<td>57,810.60</td>
<td>8071.78</td>
<td>13.96</td>
<td>10634.33</td>
<td>1484.81</td>
<td>18.40</td>
<td>2.57</td>
</tr>
<tr>
<td>1999</td>
<td>77,088.50</td>
<td>3637.14</td>
<td>4.72</td>
<td>16704.39</td>
<td>788.14</td>
<td>21.67</td>
<td>1.02</td>
</tr>
<tr>
<td>2000</td>
<td>102,704.70</td>
<td>22295.56</td>
<td>21.71</td>
<td>23738.31</td>
<td>5153.21</td>
<td>23.11</td>
<td>5.02</td>
</tr>
<tr>
<td>2001</td>
<td>121,401.40</td>
<td>25495.00</td>
<td>21.00</td>
<td>11563.60</td>
<td>2428.42</td>
<td>9.53</td>
<td>2.00</td>
</tr>
<tr>
<td>2002</td>
<td>145,325.00</td>
<td>27773.00</td>
<td>19.11</td>
<td>24322.32</td>
<td>4648.23</td>
<td>16.74</td>
<td>3.20</td>
</tr>
<tr>
<td>2003</td>
<td>168,649.40</td>
<td>36340.00</td>
<td>21.55</td>
<td>30038.50</td>
<td>6472.60</td>
<td>17.81</td>
<td>3.84</td>
</tr>
<tr>
<td>2004</td>
<td>202,387.00</td>
<td>47,723</td>
<td>23.58</td>
<td>29005.81</td>
<td>6839.59</td>
<td>14.33</td>
<td>3.38</td>
</tr>
</tbody>
</table>
Figure 3 shows the percentage of the tax evaded to the tax collected for each of the years under enquiry.

**Figure 3**

![Percentage of estimated tax revenue to actual tax revenue 1990-2004](image)

The results from these calculations are just indicative of tax Evasion in Malawi.

### 4.3 More Proxy Indicators of the Extent of Tax Evasion

Statistics from the Tax administration provide good proxies for proving existence of tax evasion. The Tax Audit and Investigations Division of MRA handled a total number of 75 VAT cases in the 2004/2005 financial year. Out of these they were able to assess and quantify additional taxes which were equivalent to 3% of the total VAT collected in that year.

The Large Taxpayer Unit of the Income Tax Division conducted an audit in the same financial year (2004/2005). From the audit, the Unit was able to quantify and assess additional taxes which were equivalent to 8.8% of the total company and business taxes that the Division collected. The National Tax Agency of Japan through its criminal investigation arm also conducts similar examination. Table 4.4 gives a summary of the results for the fiscal years 2002 to 2004.
Table 4.4: Tax Evasion cases in Japan.

<table>
<thead>
<tr>
<th>Fiscal Years</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of cases</td>
<td>195</td>
<td>201</td>
<td>210</td>
</tr>
<tr>
<td>Number of cases closed</td>
<td>196</td>
<td>202</td>
<td>213</td>
</tr>
<tr>
<td>Number of cases prosecuted</td>
<td>145</td>
<td>147</td>
<td>152</td>
</tr>
<tr>
<td>Total tax evaded (million Yen)</td>
<td>357,000</td>
<td>33,600</td>
<td>28,200</td>
</tr>
</tbody>
</table>

The Income Tax Division established a Tax payer Identification Unit in some of its major collecting Stations in at the beginning of the 2004/2005 fiscal year. By mid of this fiscal year, one unit (which had data available) was able to identify and register 100 taxpayers out of which 64% were identified through door to door campaigns, 23% through analysis of business registration records and 23% through analysis of Withholding Tax Information. This shows that there is still a large portion of potential taxpayers that are operating in the parallel economy and hence outside the tax administration reach. The value of penalties as a percentage of total revenue collected increased from 0.03% in the 2003/2004 financial year to 0.04% in the 2004/2005 financial year. From the above statistics one is able to appreciate the problem and presence of tax evasion in Malawi, even though the statistics are not painting a complete picture.
SECTION 5

5.1 COUNTERACTING TAX EVASION IN MALAWI

5.1.1 INTRODUCTION

Counteracting Tax evasion is one of the most complex activities in Tax Administration. This is because Tax evasion takes many forms and facets. One of the major keys to successfully carry out such activities is to first and foremost understand the behavior of taxpayers and the reasons that cause such specific behavior. Section 3 gives a fair summary of the relationship between Tax Evasion and the behavior of Taxpayers. We sum up the relationship in this section (3) in the in Appendix II. This framework tries to explain Tax Evasion behavior by utilizing the Rational Choice Theory. It is assumed that the taxpayers’ decision to evade or not evade tax is rational. This decision is mainly influenced by two factors. Firstly, the higher the chances of the evasion being detected, the lower are the chances that the Taxpayer will evade, and the lower the chances of the evasion being detected, the higher are the chances that the taxpayer will evade. The probability of an evasion being detected is a function of how effectively the Tax Administration is enforcing the Tax Law. Secondly, the action of evading taxes carries with it risks and costs. The tax payer will weigh these costs against the gains of evading. If the costs outweigh the gains, it is unlikely that the tax payer will evade. While on the other hand if the benefits of evading outweigh the costs, the taxpayer will likely evade. Usually, taxpayers will look at the penalty, they will incur if the evasion has been detected. This cost can be in monetary terms or the psychological effect coming from being stigmatized as a tax evader.
This simple analysis therefore gives an insight on how counteracting tax evasion should be carried out. Ultimately the fight against tax evasion has largely to do with enforcement of tax laws and is directly related to the Legal structure upon which the Tax laws are founded.

5.1.2 TAX EVASION AND THE TAX LAW

There is no Taxation without law in Malawi. This therefore establishes the Legal foundation of the Taxation system on which the definition of Tax evasion rests. MRA is by law an autonomous body. This autonomy is vital in combating Tax evasion in that the Tax body can undertake policies that it deems fit to curtail Tax Evasion without the influence of the government.

The tax law in Malawi provides a good platform for combating tax evasion. It establishes Tax Evasion as an offence under the three tax administration Acts (refer to sections 2). It also provides for penalties for tax evaders and all parties that were involved in the offence. The penalties are aimed at discouraging repeat offending for instance by also providing for custodial sentences. The law also provides for a mandatory record keeping period of 7 years which helps in ascertaining the tax base of taxpayers, wherein the identification of tax evasion cases is crucial. Where such records are missing, the Law allows the tax Administration to estimate the tax base on top of the penalty for failure to keep such record. The Law has also provided for mandatory legislation for all individuals or entities carrying out activities that are taxable, and hence making non registration at an offence. Failure to register for VAT for instance, attracts a penalty of MK100, 000.00\(^4\) and 5 years imprisonment. The Law also makes it mandatory in the civil service to provide to the Tax Administration all information that is deemed vital for taxation purposes. Tax officials are also protected under the law to carry out their activities under the tax

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\(^4\) At the time this paper was being authored, 1 Yen was equivalent to 1.1419 Malawi Kwacha and 1 US dollar was equivalent to 130.6449 Malawi Kwacha. Please note the exchange rates throughout this paper.
jurisdiction without fear thereby giving them an enabling environment to their work. For instance, the law makes it an offence to interfere in any manner when a tax official is performing his/her work, like a field audit or examination for example.

5.1.3 TAX EVASION AND TAX ADMINISTRATION

The major administrative tools used in countering Tax evasion by the Malawi Revenue Authority are, Auditing, Tax Payer Education, Informant Incentive Schemes. We now discuss and analyze each one in turn.

5.1.3.1 Tax Audit and Criminal Investigations

Tax auditing is a very valuable and strategic function in taxation. It helps in checking whether taxpayers and tax officials are complying with taxation statutes, and hence helps to bring to light any irregularities in the taxation processes. It also helps to reduce incidences of tax evasion as most taxpayers are usually reluctant to engage in evasion because of fearing an audit.

MRA realizes the importance of auditing too. Apart from the mandatory requirement stipulated in the Taxation act that each and very taxpayer should be audited every 3 years, it also has a full Division that is dedicated to tax auditing and criminal investigations. (refer to appendix I). The Audit division carries out its activities by setting targets of number of audits to carry out and number of cases to successfully prosecute in each year. We now look at the assessment system of direct taxes.

Malawi employs the Official Assessment System which means that there is a thin line between the tax examination and auditing systems. However the Tax Audit section has special tax auditors who audit the returns of incomes. Currently the division has 8 auditors who work in teams of 2 which translate to four teams under the supervision of the Director of the Division.
The Audit team is given access to all the Returns submitted and then they select which cases to do an Audit & Investigation (hereafter referred to as A & I). Possible candidates for this exercise include those that report persistent losses, cases of sudden jumps in profits, and those reporting abnormal or huge credits. To avoid malice or ill intentions, the selected cases have to be backed with full reasons as to why they have been selected. The selected cases are then handed over to the Director of the Tax Audit and Investigation who also goes through them before approving or disapproving an A & I. When an A & I has been approved by the Director, the auditors start preparing the ground work for the A & I. (This basically includes informing the Taxpayer when the Audit is to take place and what information will be required by the auditors.). This done, then a field examination follows on the scheduled date, where the auditors usually conduct an initial interview with the Taxpayer and also request for the information that they indicated they will need. (In the field examination process, the auditors are supposed to conduct themselves in a manner which will cause no disturbances to the business premise they are auditing). The auditors may also carry (by way of borrowing) different documents from the Taxpayer to their offices which they deem necessary. Thus, back to the office, they continue to work on the cases through consultation amongst themselves until they make final findings and propose the necessary adjustments to the Returns. A final briefing report is then made to the Supervisor upon whose approval; a final briefing (or interview) is made with the Taxpayer, mainly to inform him or her of their findings. This is then followed by a demand for the additional tax liability to be paid. If the Taxpayer is in agreement with the findings he has to pay immediately or makes proper arrangements to settle the shortfall. If the case is highly criminal in nature, the Division refers it further to the Public Prosecutor who takes it up in line with the criminal procedures code of the Republic of Malawi. In this case the Division becomes state witness if the case is finally.
TAID plays two roles in Malawi. Firstly, in presence alone is reason enough for Taxpayers to refrain from engaging in tax evasion and secondly, it augments the efforts of the three main tax collecting divisions. For instance, in VAT, out of all the revenues that were collected after quantification of assessment, 34.8% was collected by TAID. General data of number of cases handles in total were however unavailable except for VAT cases in which TAID handled 74.

5.1.3.2 Taxpayer Education.

MRA has a fully fledged division that handles Taxpayer Education. (Refer to appendix 1). Tax education plays an important role in bringing about tax awareness and also a vibrant tax culture. Taxpayer education also helps to reduce the tension that is usually present between the Government and The Tax authority on one hand and Taxpayers on the other. The tension only leads to one thing, low compliance levels usually as a result of Tax evasion. Conventionally, some studies have also shown that high levels of tax morale and compliance cannot be entirely explained by enforcement alone (Graetz and Wilde), gives the rationale and scope for Taxpayer Education.

In Malawi, taxpayer education is carried out in a number of ways. The most prominent is through the production of brochures that explain the various types of taxes and also elaborate the consequences of non compliance. Then there are also some scheduled public forums on which Tax authorities meet taxpayers face to face, where these two parties exchange views and taxpayers seek some clarifications on tax matters that they do not fully understand. These public forums have at least managed to stimulate some interest in tax issues in the general public. The division also runs a Program on the national radio where it discusses tax issues. Taxpayers are sometimes accorded an opportunity to phone in and air their views or questions to tax experts. The division also maintains a website where among other things there is also a tax calculator for
some taxes. Additionally the division carries a weekly corner in one of the popular daily newspaper where there are discussions on some pertinent tax issues covering all forms of Taxation.

5.1.3.3 Informant incentive scheme

With the full realization that MRA can not manage to effectively monitor and police all activities concerning taxes in Malawi, it therefore involves the general public in its activities, especially as regards to policing tax law violations which smack fraud and evasion. To lure the general public into participation, it has come up with an incentive scheme. Any member of the general public who has information that leads to a successful apprehension and conviction of a tax offender is offered a monetary award that is tied to the evaded amount of Tax. Table 5.1 shows the reward scheme at the time of writing this paper.

Table 5.1

<table>
<thead>
<tr>
<th>Amount Evaded (MK)</th>
<th>Reward (MK)</th>
</tr>
</thead>
<tbody>
<tr>
<td>10,000.00</td>
<td>5,000.00</td>
</tr>
<tr>
<td>10,001.00 to 50,000.00</td>
<td>10,000.00</td>
</tr>
<tr>
<td>50,001.00 to 100,000.00</td>
<td>20,000.00</td>
</tr>
<tr>
<td>100,001.00 to 500,000.00</td>
<td>40,000.00</td>
</tr>
<tr>
<td>500,001 to 1,000,000.00</td>
<td>80,000.00</td>
</tr>
<tr>
<td>1,000,001.00 to 2,500,000.00</td>
<td>150,000.00</td>
</tr>
<tr>
<td>2,500,001 and above</td>
<td>250,000.00</td>
</tr>
</tbody>
</table>

What has come out, however, is that this method works better with indirect taxes rather than direct taxes.
5.2 WAY FORWARD; ANALYSIS OF THE METHODS AND A QUEST FOR IMPROVEMENT

In this section we take closer look at the methods described in section 5.1 and suggest how they can be improved to effectively counter tax evasion. We also suggest other methods that can be employed in Malawi to counter tax evasion.

5.2.1 Reviewing the Taxation Laws

The tax laws should create an enabling environment for tax administration. If a country’s tax law is weak, the duty of tax administration let alone counteracting tax evasion becomes difficult too. Tax laws should also be reviewed periodically to reflect changes in the economic environment. For a long time there has not been any review of the Taxation Acts in Malawi. For instance, some penalties that are imposed upon violation of the taxation laws are given in absolute monetary figures. However due to inflation, some of these penalties lose their effectiveness as the value is eroded by inflation. Malawi therefore needs to change such types of penalties’ to percentages. This would help to parry the erosive power of inflation on penalties.\(^5\) There is need to come up with a form of harmonization especially on the common aspects of the three taxation acts currently in use. An overview of the three acts reveals that the VAT act has stiffer penalties

\(^5\) As an example we hereby reproduce some penalties in the Taxation act that were until their amendments in 1999, not really effective since they had been eroded by inflation. Note:- 1 Malawi Kwacha is approximately equivalent to 1 Japanese Yen.

"Any person who assists in or induces the making or delivery for any purposes of income tax of any return, accounts, statement or declaration which he knows to be incorrect shall be liable to a fine of K1, 000." (Section 115). "Any person who obstructs or hinders an officer in the discharge of his duty under the Act or rules shall be liable to a fine of K5, 000." (Section 116)

These figures were revised upwards to MK50, 000.00 but sooner they will need to be revised again to cope up with the current level of inflation.
than the other two Acts. This is because the VAT act has been formulated recently and therefore reflects the present reality.

There is need to incorporate a law regulating the practice of tax accountants. The present scenario in the law depicts that there is no focus on Tax Practitioners, especially in the indirect taxes (import and excise duty). Thus chances of these practitioners conniving with taxpayers to evade taxes are high. This may however be difficult as to implement on direct taxes because of the current system of assessment (Official). We look at the assessment system in the subsequent parts of this section. Malawi can borrow a leaf from countries like Japan and formulate its own version of the Japanese Certified Public Tax Accountant Law (Zeirishi).

The law needs to be simplified into a format that can be easily understood by taxpayers. This would also require translating the law from English to other key local languages, despite that English is the official language in Malawi.

5.2.2 Reviewing transactions that require a Tax Clearance Certificate

The use of a Tax Clearance Certificate (hereafter referred to as TCC) in transaction is one of the best ways of counteracting tax evasion as well as enforcing tax compliance. The Tax Law in Malawi provides for this\(^6\). However the coverage of transactions that are subject to the use of TCC is only limited to transfer of land and buildings (Real Estates), renewal of certificate of fitness for commercial vehicles and business residence permits. This requirement needs to be extended to other activities in the economy as well. For instance, extending it to all bidders of government tenders and suppliers would be a move towards the right direction. At present, MRA has an administrative ruling to this effect that all bidders and suppliers are supposed to present a

\(^6\) We have given this issue a sub section of its own despite the nature of the matter being similar to sub section 5.2.1 because we fill it requires immediate attention which can be easily enforced without dedicating many resources.
TCC alongside their bids. Eventually, this can be extended to the private sector (including the service sector such as Consultancies) as well. It is also imperative that policing this law should be escalated in the Income Tax Division. Again, there is need to Review the penalty which goes with the violation of this piece of legislation which is currently at MK1000.00.

5.2.3 Tax Law Enforcement

A well laid down law means nothing and remains a blue print if it cannot be properly enforced. Tax law enforcement is a two dimensional issue. In one part lays the challenge of capacity in terms of numbers and on the other lies the issue of abilities of the staff. In the paragraphs that follow, we look at both issues in turn.

As part of this study a questionnaire, was sent to the Human Resources Department of MRA. One of the aims of the questionnaire was to establish the current staffing levels in MRA, especially those in tax collecting Divisions, and also to establish whether the Human Resources Division views the present numbers as adequate. Table 5.2 is a summary of the results.

Table 5.2: Staffing Levels in MRA

<table>
<thead>
<tr>
<th>Division</th>
<th># of Technical Staff</th>
<th>Required Number</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax</td>
<td>243</td>
<td>287</td>
<td>44</td>
</tr>
<tr>
<td>Value Added Tax</td>
<td>120</td>
<td>290</td>
<td>170</td>
</tr>
<tr>
<td>Customs and Excise</td>
<td>534</td>
<td>754</td>
<td>220</td>
</tr>
<tr>
<td>Tax Audit and Investigation</td>
<td>Income tax 8</td>
<td>(Assessment unavailable)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>VAT 8</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Customs 14</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total 30</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Institute of tax Administration (Trainers)</td>
<td>Income tax 3</td>
<td>(Assessment unavailable)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>VAT 3</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Customs 3</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total 9</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>936</td>
<td>1331</td>
<td>395</td>
</tr>
</tbody>
</table>
From the table above, it can be seen that MRA is understaffed by almost 30%, but this figure can be misleading in that it does not contain the required staffing levels in the two key departments of Tax Audit and Investigations and also the Training Division since at the writing of this paper, there was no (official) assessments available from the two Divisions. There is a need for MRA to first carry out a staff requirement needs assessment on a division by division basis as there might be a possibility that some departments may be understaffed while others may be overstaffed. The Tax Audit and investigations Division should be given more attention because it is vital in counteracting tax evasion. An interview with the TAID revealed that on an informal estimate the Division needs about 40 tax auditors who also double as investigators. Basing on this estimate, we can say that TAID is understaffed by 80%, a situation that is not good for counteracting tax evasion. We illustrate this point further by looking at the law which provides for auditing each and every taxpayer, every three years. Currently the dossier shows that there are 29,148 business files (company). With the current number of auditors, it is impractical to enforce this law, and the same goes with the issue of enforcing the requirement for proper bookkeeping by the taxpayers.

The other side of the story is the capabilities of the tax administrators. This is the issue training. With reference to the Income Tax Division, training data was unavailable safe for the 2004/2005 financial year. The available data indicates that 114 officers attended a training of some kind locally and 6 officers attended international trainings in South Africa, Malaysia and Japan. These are commendable statistics. However there should be training needs assessments to be conducted periodically and that the assessments should be the basis of the training programs. This will enable tax administrators to cope with the dynamism of the tax environment.
5.2.4 Another Look at the Staffing Capacity (The Numbers Game)

The issue of inadequate staffing levels can be tackled in a number of ways. Efforts need to be made to optimize the use of the little resources including the staff available. This would involve, for instance concentrating a larger number of officers on the tax items that is crucial to the securing of tax revenue. In Malawi, a large amount of income tax revenue comes from co operations and withholding tax from salaried employees. It is therefore only right to combine the activities of the Large Taxpayers Unit with that of the Tax Audit and Investigation Division.

The other way is to improve the network between MRA and other Registration and Regulatory bodies. Such networks would improve the sharing of information between these bodies and MRA (bodies as the Registrar of companies, Malawi Law Society, City and Town Assemblies (for real estate registration of real estates), National Construction Industry, Malawi confederation of chambers of Commerce and industry, Private school association of Malawi and other similar bodies). This network would reduce the time spent in say taxpayer identification programs and free the officers involved to other areas such as auditing.

5.2.5 Reviewing Taxpayer Education.

The major challenge that also affects tax compliance in Malawi is its poor tax culture. The poor tax culture also contributes to tax evasion. Taxes are very unpopular in Malawi (as is the case worldwide) and so is the tax administration. However, it is reflective in the Malawi scenario that most of this unpopularity basically stems from lack of tax education among the general public.

Despite the present programs that MRA Taxpayer Educations has, there is still some scope for improvement. There is need to design a tailor made tax education package for Malawi. This package should be designed to reach out to the current taxpayers and the future taxpayer. The
current taxpayer needs information on not only on how to file returns correctly but also on the new developments that are taking place in the taxation system. On the other hand, targeting the future taxpayers is also crucial in building a country with a healthy tax culture. Future taxpayers, basically comprise of two groups, namely those that are about to engage in economic activities that are taxable according to the laws of Malawi and the children who are, say, currently in school. There is a conspicuous absence of tax education in the education system in Malawi, save for economics and business majors at the university. This is a worrisome situation that needs to be reviewed urgently.

Incorporating tax education on the political platform too would go along way in promoting tax awareness. This is because politics has a large following and hence it automatically becomes a good forum for tax education to the general public. On this point, Malawi would again borrow a leaf from Japan whereby Municipal authorities actively take part in Tax Education. MRA would gain much from its tax education program if they are well coordinated and targeted and ably supported by those in positions of influence in the society.

On the other hand decentralizing the current structure of the Tax education division will also be a good direction, as this offers a more focused approach. It is encouraging that currently the Income Tax Division has started this initiative by establishing one stop desks in their front tax offices to cater for public relations and taxpayer education.

The Public Relations and Taxpayer Education Unit should endeavor to include issues of Tax Evasion in its programs. Emphasis should be placed on the evils of this practice, by use of actual cases and their consequences to the perpetrators. This can be augmented by publicizing convictions and penalties of malicious tax evaders through popular media such us daily newspapers and television. The stigma that would ensue from such publicity is likely to put
potential evaders at bay. This would be a social cost to be born by potential evaders which they will have to factor into their decision on whether to evade taxes or not. On the other hand, publicizing good taxpayers (those who pay in time) would have an equal effect, in thus such publicity would generate a social gain on the taxpayers by enhancing their public image.

5.2.6 Reviewing the Incentive Scheme

Tax administrations need to be very sensitive in the use of incentive schemes. The present incentive scheme that MRA has does not reward compliance. This needs to be reviewed to incorporate incentives for taxpayers that are compliant. For instance, though keeping of accounts records is a requirement under the tax law, this practice is very minimal, especially among small and medium taxpayers. An incentive scheme can be designed to encourage record keeping among this group. Such an incentive would ultimately minimize evasion that comes by lack of records which forces the Tax administration to use presumptive taxation methods.

Incentive schemes need to be periodically evaluated to check their effectiveness. For instance, when Malawi introduced the Value Added Tax in 2002, there was an incentive which aimed at encouraging retailers to use cash registers by refunding import duty that was paid on the registers. There is a need to see how effect this incentive was on keeping of records among VAT registered taxpayers.

5.2.7 Reviewing the Assessment System

Malawi still uses the Official Assessment system, in income taxation. However Malawi needs to graduate to the self assessment system. For instance, due to inadequate staffing levels, in 2003/04 financial year, there were about 24,828 active business (company) files in the income
tax system. However, only 14,969 files were assessed, representing a 60% assessment rate. In the 2004/05 financial year, there were only 15,720 active files in the main tax collecting offices (Blantyre, Lilongwe and Mzuzu). Out of these, 13,962 files were assessed thus about 97%. This shows that in each and every financial year, there are files that are due for assessment but were not done. Despite the fact that MRA uses a provisional tax collection method it is still plausible to make sure that all files are assessed. This is also in line with the principle of time value of money. Moving to a self assessment system would be a way forward. This would free staff that would then be deployed to concentrate on tax auditing and, the taxpayers would take more interest to learn the tax code and its provisions.

5.2.8 Tackling the Parallel Economy

Though this may however not be within the jurisdiction of the Tax Administration, it is an issue that still affects them. The Tax Administration therefore needs to help government on this issue by suggesting policies that would help to reduce the size of the parallel economy and bring its participants within the reach of the Tax Administration. Thus proper studies need to be undertaken using all the methods available to try to establish the size of the parallel economy and also evaluate its tax capacity, i.e. find out its viability in terms of taxation.

On its part, the Tax Administration needs to concentrate on the small and medium sector, especially those that are involved in the supplying businesses. It would be relatively easy to target this group through a thorough scrutiny of withholding tax records and also imports and export records that can be obtained from the Customs and Excise Division.

7 Major economic city centers in Malawi.

8 Provisional tax is an advanced payment of income tax made in quarterly installments. At the beginning of every year of assessment taxpayers estimate the total amount of income tax payable in that year. This estimated amount is then paid quarterly as stated in the definition in the assessment year.
In as much as not all the factors that lead to formation of parallel economies can be under the control of a Tax Administration System, it is however clear that a large parallel economy is of concern to the Tax Administration, is the sense that it largely represents an income base that is not being taxed and or a symbol of Tax Evasion. This therefore justifies the need for Tax Administrations to take a keen interest in this economy to try to bring this untaxed income into the taxable income base, especially if it can be established that Tax Policy regulations and procedures are major factors driving economic agents into the parallel economy.
SECTION 6

6.0 CONCLUSION

Tax Evasion should be given more attention in Tax Administrations. This is because it is one of the major ways in which tax revenues of a country can be stifled. Owing to the intrinsic nature of Tax Evasion to the economy of a country, methods that have to be employed to contain it also need to take into account the dynamism of the economy. This therefore begs the need for Tax administration bodies to constantly review the methods they employ to counter Tax Evasion from time to time. This should involve reviewing the tax law as well as the administrative procedures that go along with it. However at the end of the day, enforcing the tax statutes will determine the effectiveness of the law, without which, no meaningful strides can be made against Tax Evasion.

MRA needs to do a further analysis on Tax evasion. Specifically it needs to pay particular attention to its auditing procedures by looking at its capacity in this area in terms of both personnel and their abilities. Where such capacity is found lacking appropriate measures such as hiring staff and training need to be carried out. High on the agenda should be the reformation of the assessment system.

Enforcement of the tax law is a key to a successful fight against tax evasion. Therefore, how best to do it, should be the concern of every modern tax administrator.
SECTION 7

7.1 REFERENCES


Malawi Revenue Authority. Income Tax Annual Reports, 2004 and 2005


APPENDIX I: ORGANIZATIONAL CHART FOR THE MALAWI REVENUE AUTHORITY (2006)

- Commissioner General
  - D. Commissioner General
    - Finance & Admn
    - Surtax
    - Inc. Tax
    - Customs & Excise
    - Policy Planning
    - I. Techn.
    - Tax Audit
      - Finance
      - Proc. & Supplies
      - Finance
      - P. Relations
      - L. Counsel
      - Security
        - Regional Office
          - Internal Audit
            - DRM-VAT
            - DRM Income Tax
            - DRM C& Excise
              - Collecting Stations

54 Total, 13 income Tax, 12 VAT and 29 Customs
APPENDIX II: Modeling the Decision Path of A Taxpayer as regards to Whether to Evade Taxes or Not

- Low Level of penalties meted
- High Level of Tax Law Enforcement
- Probability of the Evasion being detected
- Tax Payer Evades
- Tax payers Refrains from Evading
- Pay off after Evading
- Low